DOCKET FILE COPY ORIGINAL

BEFORE THE

Federal Communications Commission

WASHINGTON, D. C.

RECEIVED

JAN 27 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	MM Docket No. 92-266

COMMENTS
OF
TELE-COMMUNICATIONS, INC.

Philip L. Verveer
Sue D. Blumenfeld
Michele R. Pistone
Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, DC 20036-3384

Its Attorneys

January 27, 1993

No. of Copies rec'd 0+4
List ABCDE

TABLE OF CONTENTS

SUMMARY

The decisions that the FCC makes in connection with cable rate regulation will impact cable subscribers, cable companies and related industries. Given that previous rate regulation of the cable industry is universally recognized to have produced very negative consequences, TCI urges the Commission to act with caution here. The risks to consumer welfare from an inappropriate rate regulatory scheme are far reaching. An inefficient regulatory scheme will slow innovative activity in programming and system development, and will divert resources from the design and production of new services toward the resolution of regulatory disputes.

Accordingly, TCI urges the Commission to adopt a regulatory structure which:

- subjects basic cable services to a benchmark approach as to reasonableness, rather than cost-of-service regulations;
- creates a "bad actor" complaint mechanism through which the class of cable systems subject to cable programming complaints can be readily identified and otherwise creates a safe harbor;
- sets the maximum rate for leased access at a level that is similar to the highest implicit fee currently being charged; and
- confines direct rate regulation of equipment to that used by basic service tier subscribers only.

A simple, flexible and efficient regulatory structure designed to incorporate these concerns will safeguard consumer interests, and permit further growth and development of cable systems and programming.

BEFORE THE

Federal Communications Commission

WASHINGTON, D. C.

RECEIVED

JAN 27 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	MM Docket No. 92-266

COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI") hereby files its comments in the above-captioned proceeding. TCI, through its operating subsidiaries, is a multiple systems operator providing cable service in 49 different states to approximately nine million subscribers. TCI is thus an interested party to this proceeding.

I. INTRODUCTION

Section 623 of the Cable Television Consumer Protection and Competition Act of 1992[1] reintroduces rate regulation for some cable services. The Notice of Proposed Rulemaking to which this pleading responds solicits comment on a wide range of issues regarding the development and

---

[1] Pub. L. 102-385, 106 Stat. 460 (1992) (the "Act").

implementation of the rate regulatory provisions of the Act.[2] The tasks set forth in this proceeding include primarily the regulation of basic cable services, cable programming, equipment and leased access. As part of its comments, TCI has also submitted an extensive analysis undertaken by Drs. Stanley M. Besen, Steven R. Brenner and John R. Woodbury with Charles River Associates which analyzes the economic effects of the Notice's proposals on the cable industry and its subscribers.[3]

Rate regulation of cable television has a most unfortunate history. Students of economic regulation to this day study the FCC's treatment of cable television in the 1960's and 1970's as a means of understanding how regulation can be misapplied to impede progress, with the benefits flowing to select private interests and the costs being burdened upon consumers as a whole. Notwithstanding this unhappy history, Congress has decided to reregulate the industry within certain defined limits. TCI does not mean to challenge that judgment here; the FCC's obligations lie plainly in implementing the congressional directives. However, the constitutional merit of several aspects of the congressional directives, including Section 623, is dubious. Several parties have chosen to

---

2 Implementation of Rate Regulation Sections of Cable Television Consumer Protection and Competition Act of 1992, MM Dkt 92-266 (rel. Dec. 24, 1992) (the "Notice").

3 Besen, Brenner and Woodbury, "An Analysis of Cable Television Rate Regulation," (January 27, 1993) (hereinafter, Besen, et al.).

challenge the constitutionality of such provisions.[4] While TCI is not a party to those constitutional challenges, TCI nevertheless believes them to be meritorious.

As with almost all regulatory schemes, Congress has left much of the "details" of cable television regulation to the FCC. Those details will determine the course of progress for the cable industry and its related industries in the 1990s. The new Act requires fundamental changes to the way business is currently being conducted in the industry; whether these changes improve consumer welfare or diminish it may be largely in the hands of this agency.

TCI has already commenced the adjustment process. It has begun the necessary retiering, anti-buy-through reconfigurations, billing system and other changes anticipated by the Act. These changes are costly and sometimes awkward, and the only certainty is that more changes will be made as experience is gained under the new regime. TCI believes that one of the most important tasks before the Commission is to see that cable customers are not burdened with unnecessary system disruptions or excessive costs that may result from the abrupt implementation of these new rules. Thus, TCI urges the Commission to implement only interim rules on April 3, 1993, with "permanent" rules to follow on January 1, 1995. This will

---

4 Time Warner Entertainment Company L.P. v. Federal Communications Commission, Civil Action No. 92-2494 (D.D.C. Filed Nov. 5, 1992).

permit cable rates to be constrained per legislative instruction, but permit refinements to be made as inevitably they will be needed thereafter.

As to the form of regulation, the importance of these proceedings cannot be overemphasized. The interests of consumers in the growth of cable systems, and in the innovative development of cable programming and services are at risk. In order to safeguard consumer interests, and to ensure further growth and development of cable systems and programming, the Commission must design rules that are flexible, simple, and efficient. As Besen et al. point out:

> just as cable was directly restricted in the [1960's and 1970's] in its ability to provide the public the services it desired, it may similarly be restricted indirectly if the rates it can charge for services are unduly constrained. Setting the prices of cable services that render unprofitable higher quality but higher cost programming can reduce the value of cable services to consumers as much as, and in the same way as, past limitations of the programming that could be offered by cable systems.

Besen et al., at 6.

TCI therefore urges the Commission to adopt a regulatory structure which:

- subjects basic cable services to a benchmark approach as to reasonableness, rather than cost-of-service regulations;
- creates a "bad actor" complaint mechanism through which the class of cable systems subject to cable programming complaints can be readily identified and otherwise creates a safe harbor;
- sets the maximum rate for leased access at a level that is similar to the highest implicit fee currently being charged; and
- confines direct rate regulation of equipment to that used by basic service tier subscribers only.

* * *

Before discussing the particular issues involved in implementation, TCI first sets forth its understanding of the overall regulatory regime into which each of the implementation issues must be incorporated. The new Cable Act delineates three distinct categories of cable programming: (1) a single tier of basic cable services; (2) cable programming services; and (3) video programming offered on a per channel or per program basis. It continues to prohibit rate regulation except as specifically permitted. <u>See</u> <u>Act</u>, § 623(a)(1). The 1992 Act has set up different rules regarding the regulation of the first two of these categories, § 623(a)(2)(A) and (B), and forbids regulation of the third, § 623(a)(1).

Basic cable services are subject to direct regulation under the Act. The Act mandates the minimum contents of the basic service tier: television broadcast stations (other than superstations) and public, educational and governmental access programming. Basic cable services provided by cable systems that are not subject to effective competition may be regulated, if the local authority elects to do so, under § 623(b), to ensure their reasonableness. It is anticipated that these local services will be regulated by local franchising authorities which have the legal authority to regulate rates. Such local rate regulation would be subject to federal supervision and enforcement.

Rates for cable programming services, in contrast, are not directly regulated. Act, § 623(c). Rather, these services are subject to regulation only if they are found, upon complaint, to be unreasonable. The statute instructs the FCC to (1) establish criteria "for identifying, in individual cases, rates for cable programming services that are unreasonable", and (2) design complaint procedures which are to "include the minimum showing that shall be required for a complaint to obtain Commission consideration and resolution of whether the rate in question is unreasonable". Act, § 623(c)(1). Only the FCC has the authority to regulate rates for cable programming services. And only a minority of cable operators -- the euphemistic "bad actors" -- were intended by Congress to be affected: "The legislation will protect consumers from unreasonable behavior by the 'renegades' in the cable industry." H.R. Rep. No. 628, 102d Cong., 2d Sess. 30

(1992) ("House Report"). Senator Inouye echoed this approach when he stated that:

> In addition [to basic tier regulation], both S.12 and the conference report include what could be called a bad actor provision. The conference report provides that the FCC may regulate, on a case-by-case basis, rates for tiers of programming other than basic if it receives a complaint that demonstrates that a rate increase is unreasonable.

138 Cong. Rec. S14224 (1992).

Video programming offered on a per channel or per program basis cannot be regulated at any level. As these services do not fall within the statutory definitions of either basic cable service or cable programming service, they are exempt from regulation.

This statutory scheme reflects Congress' paramount concern that local television broadcast signals and PEG access programming be available to the greatest possible number of homes passed.[5] It reflects an assessment by Congress that the basic service tier, encapsulating the "antenna service" function cable systems perform, required direct regulation to promote localism and affordability. The governmental interest in assuring availability by regulating rates was deemed to diminish significantly in the case of cable programming, both because of Congress' perception of competitive levels as well as its recognition that the recent growth in cable networks was

---

5 Act, §§ 2(a)(17), (19).

largely due to the deregulatory policies of the 1984 Act. The governmental interest in any form of regulation with respect to pay programming is absent altogether, and it is reflected accordingly in the Act.

In implementing this statutory schema, the Commission should recognize that the existence of a directly regulated basic service tier has a constraining effect on the pricing of cable programming services. If the price for cable programming services exceeds the value consumers place on these services, consumers may readily elect to take the lower cost, lower priced basic service tier. The Commission should not lose sight of the fact that broadcasters, and especially network affiliates, continue to dominate audience shares. Thus, the Notice is correct in reflecting that "there may be a tradeoff between the severity of the restrictions that may be placed on basic tier rates and rates for other programming services." Notice at ¶ 94. It is a valuable tradeoff; constraining basic service tier rates to a reasonable benchmark permits freer rein for cable programming services because valuable consumer choices are inherently available in this schema.

II. STANDARDS AND PROCEDURES FOR IDENTIFYING CABLE SYSTEMS SUBJECT TO RATE REGULATION

A. Effective Competition Measurement

The Act provides that rates for the provision of basic cable services shall be subject to regulation by the local franchising authority if the cable system is not subject to effective competition. Act, § 623(a)(2). If the cable system is subject to effective competition, rate regulation of its basic cable services is prohibited.

Effective competition is defined statutorily in three alternate ways. Act, § 623(1)(1). The first test provides for a straightforward measure of penetration below 30%. Under the second test, Section 623(1)(1)(B), effective competition exists if each of two multichannel distributors offer service to at least 50% of the households in the franchise area, and 15% of the households in the franchise area are served by distributors other than the largest distributor. The third test finds effective competition if there is a multichannel distributor operated by the franchising authority which offers service to 50% or more of the households in the franchise area. Act, § 623(1)(1)(C).

The Notice seeks comment on several issues related to the definitions of effective competition. Notice, at ¶¶ 7-9. The Notice first asks how the term "offer" should be defined in making the calculations in § 623(1)(1)(B) and (C). Notice, at

¶ 8. The Notice proposes that such services be "actually available" in order to be counted. Id.

The term "offer" should be implemented by reference to an industry term of art -- homes passed. As used by the cable industry and by the Commission, the phrase homes passed means the number of homes a particular cable system has the technical capability to serve promptly if a potential customer were to order service. Both governmental and industry sources already report such statistics for cable. See, e.g., FCC Form 325, Schedule 1 (Community Unit Data); Television and Cable Factbook: Cable and Services Volume D-12 (Warren Publishing 1992). As the Commission already utilizes these data for other purposes, it should utilize this existing method for calculating cable service offerings under the second and third tests of the effective competition standard.

The Commission should seek to establish an analogous type of measurement method for other non-cable multichannel video programming distributors using alternative technologies. "Actual availability" is too narrow to be an appropriate analogy, since the concept of "homes passed" does not encompass actual availability in the sense that the drop to the home may yet need to be installed to any particular home. Thus, availability should comprehend availability in the sense of being able to bring service to a household with marginal additional investment. Cf. Section 705 of the Communications Act, 47 U.S.C. § 605 (exempting certain programming in part by reference to whether "a marketing system" is established). And, as detailed below, regulations regarding the measurement of service availability by any multichannel video programming distributor could be implemented with relatively modest administrative effort.

The Commission should implement a service area home count reporting requirement annually on all multichannel video programming distributors. Otherwise, cable operators will find it difficult, if not impossible, to make a requisite showing of effective competition standards. In certain situations, this measurement could be incorporated into existing annual reporting forms currently filed by several multichannel video programming services. For example, wireless cable service providers could be required to submit measurements of the number of television households that it technically could serve, with its annual FCC Form 430. For purposes of counting households, it should be clear that each unit in a MDU is counted separately. The "homes passed" measurement for non-cable multichannel video programming service providers should be reported by zip code in order to make the data usable by all interested parties.[6]

---

6 TCI agrees with the Notice's proposal that in the event the wireless cable operator is purely a lessee and does not hold any of the relevant licenses, the licensee should be required to obtain and report the relevant information.

Similarly, television receive-only satellite ("TVRO") programmers and future direct broadcast satellite ("DBS") service providers also should submit statistics relative to their national "footprint" and penetration levels. As such services are nationwide in nature, these measurements must be set out by zip code; each code should be supplemented with appropriate listings of authorized vendors and/or direct sale locations. These reporting statistics are already demonstrably feasible for TVRO programmers, which, pursuant to the Satellite Home Viewers Act, may only sell network signals to customers located in "white" areas. The records collected by the Commission must be readily accessible to the public. Thus, if a cable operator sought to establish that it was subject to effective competition under the second or third tests, it could collect the relevant data from the FCC and attempt to make the required showings.

The Commission's tentative determination to measure penetration cumulatively for purposes of applying the second effective competition test is consistent with the Act. See Notice, at ¶ 9. Although it is not a model of clarity, the language of Section 623 appears to contemplate a cumulative approach rather than individual measurements. The second test, contained in Section 623(l)(1)(B) states that the 15 percent penetration level should be measured by "the number of households subscribing to programming services offered by multichannel video programming distributors . . ." If Congress sought to require each multichannel video programming distributor to reach a 15 percent penetration level in order to satisfy the statutory burden, it would not have used the plural form of the term "distributor". And if there were more than six such distributors, it is quite possible that no one of them would have a 15% penetration level. Moreover, when Congress intended individual measurements, such as the 50 percent availability test in § 623(l)(1)(B), it did so clearly by using the term "each." Thus, an interpretation that accumulates the penetration levels of each competitor is warranted here.

B. Multichannel Video Programming Distributor Should Be Broadly Defined

The statutory definition of a multichannel video programming distributor is a person who "makes available for purchase, by subscribers or customers, multiple channels of video programming." Act, § 602(12). The plain language of the Act establishes that the term multichannel video programming distributor be broadly construed to include, among others, cable operators and Multichannel Multipoint Distribution Service ("MMDS") operators, DBS and TVRO distributors. Id. The statute states explicitly that Congress' list of multichannel video programming distributors is illustrative, not exhaustive. Id. (defining the term to mean "a person such as, but not limited to . . . ."). A broad definition of multichannel video programming distributor would serve the statutory goal, and enable the FCC to accommodate future advances.[7]

Any distributor offering multiple video programming choices to viewers should reasonably be considered a multichannel video programming distributor. The number of channels offered by a particular distributor is not an accurate measuring stick. With video-on-demand, one channel is sufficient to offer simultaneously a wide array of programming choices. Leased access users that offer compressed, multichannel service should also be classified as multichannel video programming distributors. The statutory definition of a multichannel video programming distributor does not mandate that a distributor be facilities-based as a prerequisite to inclusion in the statutory definition. Rather, by including TVRO distributors in the definition Congress has recognized that video programming distributors exist in various forms. Furthermore, the Commission should conclude that broadcasters

---

7 Forecasts abound of the numerous potential modes of home video delivery. See "Bell Atlantic Test Challenges Cable Monopoly," W. Post, Dec. 16, 1992, at F1 (Bell Atlantic to deliver video services to household customers); "TV Via Telephone Lines Planned for Manhattan," N.Y. Times, Oct. 5, 1992, § B, at 3, col. 5 (video dialtone to be implemented in early 1994); 'DirecTV reaches Agreement with Sony" Broadcasting, Oct. 19, 1992, at 72 (subsidiary of Hughes set to launch DBS services); 'Digital Compression: Now Arriving on the Fast Track," Broadcasting, July 27, 1992, at 40 (development of digital compression moving 'rapidly and competitively"); "USA Video Plans Video-On-Demand Tests, Television Digest, July 13, 1992, at 3 (video-on-demand being tested).

who program more than one channel in the same service area are multichannel video programming distributors within the meaning of the Act.[8]

The Notice also seeks comment on the definition of "comparable" programming. Notice, at ¶ 9. The Commission should not attempt to make these assessments. The consumer market for multichannel video services has effectively defined, and will continue to define, "comparability." Thus, any measurable penetration by a video programming distributor indicates consumer acceptance of the programming, and should be deemed to establish comparability. Otherwise, the Commission would put itself in the position of judging programming content and quality, a position at odds with the First Amendment.

III. RATE REGULATION ALTERNATIVES

A. Regulatory Approaches for Basic Tier Regulations

The Notice identifies "two generic approaches" for regulating basic service tier rates: benchmarking and cost-based. Notice at ¶ 33. Because the Commission's subsequent analysis and description includes as well a "price cap" approach, TCI discusses all three alternatives below.

The analysis of Besen et al. discusses the potential costs inherent in these regulatory alternatives. They conclude that overall, consumers and cable companies alike are best

---

8 Comm. Daily, "Broadcasters Push 'Ancillary' Uses for HDTV Channels," at 1 (Jan. 11, 1993).

served under a benchmark approach, a conclusion consonant with the tentative finding of the Notice:

> [W]e . . . believe that the Commission's tentative conclusion not to use conventional cost-of-service regulation is appropriate. Such regulation can impose substantial costs on consumers, particularly in a market like cable television that is characterized by product or process innovation. . . . [T]he nearly continuous introduction of new program services and new ways of delivering those services, render the cable industry and cable consumers particularly vulnerable to the rigidities of cost-of-service regulation. In addition, of course, cost-of-service regulation discourages efficiency in production and creates large administrative costs.

Besen et al., at 2.

The actual regulatory scheme for the basic service tier should be as simple and efficient as possible. As explained below, and by Besen, et al., cost-of-service regulation and the telephone price cap regimes are inappropriate models for the Commission's tasks here. TCI strongly urges the Commission to devise a simple benchmark by which its statutory duties to establish regulations for basic service tier rates will be discharged. As Besen et al. indicate "[t]he elimination of two major adverse incentives under cost-based and rate-of-return regulation is evident in two behavioral predictions associated with benchmark regulation." Besen et al., at 30. First, since companies will be able to retain cost savings as additional profits under benchmark regulation, firms will have an incentive to reduce costs. Id. Indeed, their profits increase as they reduce costs. Second, "because correctly-implemented benchmarks are tied to factors beyond the control of the regulated firm, and not to its own costs, regulated firms have incentives to innovate and to offer desired new services if the costs of the innovation do not exceed the benchmark rate." Id. Thus, benchmark regulation parallels more closely the performance of a competitive market.

As Besen et al. discuss, it is important that the benchmark be designed on a per-channel basis, rather than on the tier of channels comprising the basic service tier. Id. at 16-17. The benchmark must also appropriately account for the variety of marketing approaches utilized by cable operators, including the bundling of equipment and services. Id. at 18-23.

A number of benchmarks have been proposed in the Notice, including benchmarks designed with regard to either rates charged by systems facing effective competition or past regulated rates. Notice, at ¶¶ 41-45. The Commission's data gathering efforts will permit analysis of these benchmarks, and will help discern which may be better suited because of availability of data, consistency of rate structures, degrees of "bundling," etc. TCI withholds further comment until both the data and the FCC's proposed usage thereof is available to the Commission and the industry for analysis and review. TCI urges the Commission to make such data available to the public for independent analysis.

The benchmark selected will of course need to be adjusted over time. Either rate increases for "effective competition" systems, or some appropriate index to adequately reflect cost trends for the cable industry can be used. This is especially important given the dramatic increases in programming costs that cable systems have faced in recent years. See Besen et al., at 33-36.

The virtual consensus to prefer benchmarks over rate-of-return regulation, indeed, over any cost-based system for regulating basic service tier rates, should come as no surprise. Traditional public utility regulation has been studied for several decades now, and its costs and inefficiencies are documented in full.

> Cost-of-service ratemaking is often used where the object of regulation is to replicate those prices that would exist in well-functioning competitive markets. But certain inherent defects in the cost-of-service ratemaking system make this objective impossible to achieve.

See Breyer,"Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform," 92 Harv. L. Rev. 547, 562 (1979). Cost-based regulation distorts the efficient incentives that would otherwise prevail in the absence of regulatory constraints, even for a firm with market power:

> These incentives arise, in large part, because rate of return regulation ties profit to the levels of investment or costs. They lead to distortions in the regulated firm's choices of both inputs and outputs, in comparison to choices that would be socially efficient ....

See "Telecommunications in Transition: The Status of Competition in the Telecommunications Industry, Majority Staff Report, House Subcommittee on Telecommunications, Consumer

Protection, and Finance at 58-59, 97th Cong., 1st Sess. (1981). These problems have been repeatedly recognized in the Commission's own efforts to move away from traditional utility regulation forms. See, e.g., Price Cap Proceeding, 4 F.C.C. Rcd 2873, 2889 (1989), recon., 6 F.C.C. Rcd 665 (1991) (rather than encourage socially beneficial behavior by the regulated firm, rate of return actually discourages it); Second Computer Inquiry, Final Decision, 77 F.C.C. 2d 384, 461 (1980), recon., 84 F.C.C. 2d 50, 74-75 (1980), further recon., 88 F.C.C. 2d 512 (1981), aff'd sub nom., CCIA v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983). The Commission should not reverse its trend here.

The inappropriateness of cost-based regulation was echoed by Congress.

> The Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation. The FCC should create a formula that is uncomplicated to implement, administer, and enforce, and should avoid creating a cable equivalent of a common carrier "cost allocation manual."

House Report at 83.

Notably, the 1992 amendments to the 1984 Act left intact the prohibition found in § 621(c): cable systems may not be regulated as "a common carrier or utility by reason of providing any cable service." Common carrier regulation plainly connotes cost-of-service principles.

As Besen et al. discuss, there are considerable administrative costs associated with cost-based regulation necessitating the investment of substantial administrative resources. See Besen et al., at 24-26. These direct costs are incurred without any level of confidence that the regulation has achieved its purpose: to replicate competitive outcomes. These problems are exacerbated in the context of cable, where the heterogeneity of service offerings and rapid technological changes increase both the costs of regulating, and the probabilities that such efforts will be harmful. Besen et al., at 23-29.

Even more troublesome, cost-based regulation slows innovation. In an industry that provides entertainment and information, reduced innovation can have profound social as well as economic effects. As just one example, it is far from clear that the initially risky proposition of CNN would have survived in a rate regulation environment.[9] Congress clearly did not intend that the Act impede growth of the cable industry or its programming. Indeed, a stated purpose of the Act is to "ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their cable systems." Act, § 2(b)(3).

---

9 See N.Y. Times, "Turner Deal Comes Just in Time," at D1 (June 4, 1987) (investment by 26 operators of cable systems maintained financial stability of Turner Broadcasting System Inc., owner of CNN).